CHAPTER 1

THE U.S.-CHINA TRADE AND ECONOMIC RELATIONSHIP

OVERVIEW

China is America's third largest trading partner, behind Canada and Mexico.[1] But China's trade relationship with the United States is extremely unbalanced. China exports to the United States six times the value that it imports from the United States. In 2005, total U.S. exports to China were $41.8 billion, while imports from China amounted to $243.4 billion.[2] In 2006, these numbers are estimated to increase to $56.3 billion and $284.9 billion, respectively.[3] Although this lopsided economic relationship has led to heightened tensions between the two countries, the bilateral trade imbalance continues to grow. In 2006, China's trade surplus with the United States is expected to increase 13 percent to $228.6 billion.

China's global current account surplus, the broadest measure of trade and investment flows, continues to accelerate.[4] Foreign direct investment in China increasingly affects the volume and type of China's international trade. Foreign-funded firms operating in China dominate the landscape of international trade. In 2005, 58 percent of China's exports came from foreign-invested enterprises.[5] The dominance of foreign capital in the export sector is a reflection of Chinese industrial policy, which attempts to attract foreign investment to export-related manufacturing enterprise in China. Among the direct incentives for such foreign investment are tax breaks, low-interest loans, discounts on land purchases, and government-provided infrastructure enhancements.

Trade tensions between the United States and China are heightened by China's failure to abide by the international trade agreements to which it is a party. For example, China agreed in 2001 as part of its application to join the World Trade Organization to eliminate certain government subsidies meant to encourage exports. China, however, still has an industrial policy that employs a wide variety of subsidies to promote favored industries. As a result, U.S. exporters and some U.S. investors, particularly those in financial services, face a variety of non-tariff barriers and major impediments to conducting business in China.

The U.S.-China trade and investment relationship exposes U.S. industry and the U.S. innovation base to huge levels of intellectual property theft—in the case of entertainment software, approaching the 100 percent level. This is a growing problem for U.S. competitiveness as intellectual property industries contribute to more than half of all U.S. exports and represent 40 percent of U.S. economic growth. Fifty-five percent of U.S. companies operating in China were hurt by intellectual property rights violations according to a business association survey in 2006.[6] The U.S. Chamber of Commerce estimates that the global intellectual property industry loses $650 billion in sales due to counterfeit goods.[7] And some analysts estimate that China is responsible for as much as 70 percent of this counterfeit goods market.[8]

U.S. businesses and workers and the overall U.S.-China trade and investment relationship are vulnerable to harm from China's non-market-oriented financial system and monetary policy, as well. For example, China maintains an extensive system of subsidies for manufacturing based in China, from easy money and loan forgiveness from the banks to an artificially low exchange rate for the renminbi. Chinese banks are predominately state-owned or state-controlled and often are expected to grant loans with below-market interest rates, carry large amounts of defaulted loans on their books, or forgive such debts of government-owned companies. In a centrally planned economy such as China's, these loans are a device to preserve internal stability and strengthen the control of the Chinese Communist Party. Furthermore, China's government undervalues the renminbi relative to the dollar at a level estimated by most economists to be between 15 percent to 40 percent.[9] The undervalued renminbi makes U.S. products more expensive in China than they would be if the renminbi were allowed to seek its own level in the international currency markets. As a result, U.S. manufacturers are able to sell fewer of their goods to China. Conversely, the undervalued renminbi makes Chinese products less expensive in the United States than they would be if the international currency market were allowed to determine the relative value of the two currencies. Therefore, U.S. consumers buy more from China. The failure to address this problem is increasingly a factor in U.S. companies relocating production to China. The overall result is a growing U.S. current account deficit and increasing ownership of U.S. debt instruments by the Chinese. The Chinese banks now have $1 trillion in foreign currency reserves, the majority of which is held in U.S. dollar-denominated bonds.[10]

As China approaches the fifth anniversary of its admission to the World Trade Organization on December 11, 2006, these problems stand out as major impediments to a more equitable and rules-based trading relationship between China and the United States. There is a great deal at stake in the seeming minutiae of trade agreements, because the decisions of two of the world's economic giants have consequences for their 1.6 billion residents as well as for those in Europe, Africa, and Latin America. Jobs, industries, and entire regions can be jeopardized by the irresponsible actions of other nations in a global economic system that is ever more intertwined. This chapter will highlight some of the problems that continue to rend the fabric of fair trade: currency manipulation, counterfeiting, export subsidies, industrial polices aimed at discouraging imports and encouraging exports, hidden trade barriers, and discrimination against foreign investors. None of these practices is permitted by any of the trade agreements that China and the United States have signed. Acknowledging the harm that Chinese practices do to workers, consumers, and investors in each country is the first step in the reform that must follow.